

The Service Occupation Tax is a tax imposed upon servicemen engaged in the business of making sales of service in this State, based on the tangible personal property transferred incident to sales of service. See 86 Ill. Adm. Code Part 140. (This is a GIL.)

June 26, 2007

Dear Xxxxx:

This letter is in response to your letter dated September 6, 2006, in which you request information. We apologize for the delay in responding to your inquiry. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.ILTAX.com to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

We are a Delaware corporation ('Company') registered for sales tax with the state of Illinois and filing monthly sales and use tax forms accordingly. We are seeking to clarify the tax treatment of certain items shipped to Illinois pursuant to our advertising and promotional activities.

FACTS:

The items in question and their uses are the following:

- Brochures and similar advertising materials printed outside the State of Illinois, delivered to a third-party fulfillment house outside Illinois, and sent by the fulfillment house via the United States Postal Service to the Company's customers and potential customers within the State of Illinois, free of charge. The customers in question may include individuals, physicians, hospitals or other health care providers. Those items sent to health care providers may or may not be subsequently distributed to patients, at the discretion of the health care provider.
- Brochures and similar advertising materials printed outside the State of Illinois, delivered to a third-party fulfillment house and sent by the fulfillment house via

the United States Postal Service to our sales representatives in Illinois or nearby states, to be given to physicians, hospitals or other health care providers in the State of Illinois in conjunction with marketing activities. The sales representatives in question are employees of our company.

- Pens, beverage mugs, paperweights and similar items, obtained from a non-Illinois vendor and personalized with the name of the Company or the Company's products, delivered to a third-party fulfillment house outside Illinois, and sent by the fulfillment house via the United States Postal Service or other common carrier to physicians, hospitals or other health care providers in the State of Illinois, free of charge.

(In some cases, the mailings described in the above scenarios may be done directly by the Company rather than by a third party. The materials would, however, be mailed from one of the Company's non-Illinois locations).

- Brochures and similar advertising materials printed outside the State of Illinois and delivered outside Illinois to an unrelated party which incorporates the materials into 'kits' to be given to patients or includes them in a group of educational materials pertaining to a particular medical condition. In the latter case, the materials may be sent directly to patients via mail or common carrier, or to physicians, hospitals or other health care providers in the State of Illinois for distribution by such health care providers to patients, at the discretion of the health care provider.

In most cases, the production of the materials described above is not contracted for by the Company directly. The Company enters into contracts with advertising agencies and similar organizations which develop the concepts for promotional campaigns, design graphics, layouts, etc., either internally or by subcontract to an outside party, and arrange for the printing of the materials or personalization of the premiums or 'give-aways'. The materials are then delivered directly from the printers to fulfillment houses for distribution or, in some cases, to the Company itself.

ISSUE:

Does Illinois Retailer's [sic] Occupation Tax, Use Tax, Service Occupation Tax, or Service Use Tax apply to the various materials described above when the materials are delivered into the State of Illinois under the above scenarios? If tax does apply, how should the amount subject to tax be determined?

DISCUSSION AND ANALYSIS:

We are requesting guidance regarding both printed materials and other types of property. Accordingly, we reviewed the regulations and other authority pertaining specifically to printing and printed materials as well as those pertaining the referenced taxes in general.

Printed Materials:

Generally, under Illinois Regulation 130.2000, a person engaged in the graphic arts or related occupations is considered to be engaged in the business of selling services when it produces items for a customer on special order which would be of no value to

parties other than that customer. For example, while the sale by a printer or other party of pens, paperweights or other useful items, personalized with the customer's name, would be considered to be a sale of tangible personal property and thus subject to the ROT, the sale of business cards, personal stationery and similar printed materials would not be. Advertising and promotional printed material would appear to fall into the latter category. Therefore, the transactions described above involving printed materials would be subject to neither the ROT nor the Use Tax ('UT').

Sales of services as such are generally not subject to either the Retailer's [sic] Occupation Tax ('ROT') nor the Service Occupation Tax ('SOT') in Illinois. However, transfers of property incidental to the sale of a service may be subject to either tax, depending upon the property transferred. As noted, a provider of custom printing services is generally subject not to the ROT but to the SOT on its cost of tangible personal property transferred pursuant to the sale of a service. However, if the annual aggregate cost price of such property is less than 25% (75% in the case of servicemen engaged in graphic arts production) of the serviceman's annual receipts from services provided, the serviceman would be a 'de minimus' serviceman. In this situation, unless the serviceman is registered for tax, he would pay use tax to his supplier on his purchase of materials, rather than SOT on his sale of services to his customer.

The Company does not have sufficient information to determine whether its vendors are registered for, or subject to, Illinois tax, or how they handle such sales for Illinois tax purposes if they are subject. (We understand, also, that specific provisions apply to multi-service situations but that, too, is beyond our scope here). However, it generally is the case that the fees paid to our advertising agencies or graphic services providers are significantly less than 75% attributable to tangible personal property transferred.

Premiums and Gifts:

The acquisition by the Company of the promotional items or 'premiums' described in the third scenario above would, as previously discussed, be considered to be the acquisition of tangible personal property rather than services. Such transactions are generally subject to the ROT or UT. A taxpayer who gives away goods for no consideration as part of a promotional program is treated as the user of the goods and would owe UT rather than ROT. However, a review of previous rulings by the Department indicates its position to be that when an out-of-state donor sends, or has an out-of-state merchant send, items of tangible personal property to a donee in Illinois, no UT liability is incurred by the donor if the property is purchased outside of Illinois and sent from a location outside of Illinois because the donor has not exercised any taxable use of the property in Illinois. When the goods are delivered for shipment outside Illinois, they have entered interstate commerce and the Company no longer have any control over the items shipped; ownership of the property has passed to the donees. This treatment applies to both printed materials and other items.

RULING REQUESTED:

The Company requests confirmation by the Department of its understanding, as follows, of the appropriate tax treatment of the various situations described:

The Company is not subject to tax on its delivery, either directly or through a third party, from a location outside Illinois to customers or potential customers in the State of Illinois, of printed materials or other tangible personal property, because such transfers

take place in interstate commerce and the Company has not exercised any taxable use of these items in Illinois;

The Company is not subject to tax on its delivery, either directly or through a third party, from a location outside Illinois to the Company's representatives in the State of Illinois, of printed promotional materials, because the sale or purchase of such materials is not a retail sale of tangible personal property and thus subject to neither the ROT nor UT. The SOT and SUT are generally imposed upon the serviceman rather than the serviceman's customer. While a purchaser may be required to self-assess and pay the SUT on tangible personal property received as an incident to a purchase of service from a non-Illinois serviceman, this is not the case when the serviceman in question would not be subject to the SOT if the service were performed in Illinois. Pursuant to Illinois Regulation 160.101(a), 'if the serviceman would not be taxable under the Service Occupation Tax despite all elements of the sale of service occurring in Illinois, then the tax imposed by the Service Use Tax Act does not apply to the use of such property in this State...As a result, customers of such de minimis servicemen do not incur Service Use Tax liability on such transfers'. The Company is not subject to tax in this situation because the printed materials were obtained as the result of the purchase of a service, and the cost of the tangible personal property transferred pursuant to that purchase constituted less than 75% of the overall cost of the service.

While we understand that the Department cannot issue a binding ruling based on the information presented, we respectfully request any guidance you can provide in this matter. If you have questions or need additional information, please call.

DEPARTMENT'S RESPONSE:

Please see 86 Ill. Adm. Code 130.2000, which is the regulation for "Persons Engaged in the Printing, Graphic Arts or Related Occupations, and Their Suppliers." As a general rule, when products are items of general utility and serve substantially the same function as stock or standard items, the products will be subject to the Retailers' Occupation Tax when sold. Items which serve substantially the same function are those which, when produced on special order, could be sold as produced to someone other than the original purchaser at substantially the same price. Items that would not be considered stock or standard items and would not be sold to someone other than the purchaser for substantially the same price would not be subject to the Retailers' Occupation Tax when sold, but would generally be subject to Service Occupation Tax liability or Use Tax liability as described below.

Illinois Retailers' Occupation and Use Taxes do not apply to sales of service that do not involve the transfer of tangible personal property to customers. However, if tangible personal property is transferred incident to sales of service, this will result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. For your general information see of 86 Ill. Adm. Code 140.101 through 140.109 regarding sales of service and Service Occupation Tax.

Under the Service Occupation Tax Act, businesses providing services (i.e. servicemen) are taxed on tangible personal property transferred as an incident to sales of service. See 86 Ill. Adm. Code 140.101. The purchase of tangible personal property that is transferred to the service customer may result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. The serviceman's liability may be calculated in one of four ways: (1) separately stated selling price of tangible personal property transferred incident to service; (2) 50% of the servicemen's entire bill; (3) Service Occupation Tax on the servicemen's cost price if the servicemen are registered de minimis servicemen; or (4) Use Tax on the servicemen's cost price if

the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Normally, most printers handle their liabilities under one of the de minimis methods.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of the sale of service. The tax is then calculated on the separately stated selling price of the tangible personal property transferred. If the servicemen do not separately state the selling price of the tangible personal property transferred, they must use 50% of the entire bill to the service customer as the tax base. Both of the above methods provide that in no event may the tax base be less than the servicemen's cost price of the tangible personal property transferred. See 86 Ill. Adm. Code 140.106.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. See 86 Ill. Adm. Code 140.109. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is less than 35% of the total annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphics arts production). Servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis. Registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon their cost price of tangible personal property transferred incident to the sale of service. Such servicemen should give suppliers resale certificates and remit Service Occupation Tax using the Service Occupation Tax rates for their locations. Such servicemen also collect a corresponding amount of Service Use Tax from their customers, absent an exemption.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Such de minimis servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers are not registered to collect and remit tax, the servicemen must register, self-assess and remit Use Tax to the Department. The servicemen are considered to be the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers. See 86 Ill. Adm. Code 140.108.

The Department has recognized situations where printed materials are "used" outside Illinois and then placed for mailing by mail or common carrier outside Illinois for delivery into Illinois, and during which, the serviceman loses the ability to exercise control over the printed materials (e.g., to recall the materials). See for example ST 06-0004-PLR, ST 01-0166-GIL, and ST 01-0003-GIL. Generally, in those situations, a serviceman would not incur a Use Tax liability nor a Service Use Tax collection obligation if the serviceman does not retain the ability to exercise control over the shipment of the printed materials after entry into Illinois. This letter and the general information letters referenced above also describe the general tax liabilities of printers in special order printing situations. Such liabilities may accrue, if the serviceman were to have any control over the printed materials in this State.

I hope this information is helpful. If you require additional information, please visit our website at www.ILTAX.com or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Terry D. Charlton
Senior Counsel, Sales & Excise Taxes

TDC:msk